Unrelated Business Income and Expenses

Responsible Officer:	~~EVP - Chief Financial Officer~~AVP - Systemwide Controller
Responsible Office:	FA - Financial Accounting
Issuance Date:	TBD
Effective Date:	11/1/2020
Last Review Date:	January 17, 2012~~7~~
Scope:	This policy applies to the income and expenses of unrelated business activities conducted by the University of California campuses and Agriculture and Natural Resources. This policy does not apply to the Lawrence Berkeley National Laboratory (LBNL), or to campus entities which are separately incorporated or exempt under Section 501(c) of the Internal Revenue Code (Code). Examples of such entities include: • ASUC-operated enterprises; • Foundations; • Alumni associations; and • Faculty clubs. Those entities are responsible for filing their own annual information and income tax returns with the IRS and the Franchise Tax Board.

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I. POLICY SUMMARY

It is the policy of the University to comply with IRS regulations, which includes filing the Exempt Organization Business Income Tax Return (IRS Form 990-T) for Unrelated Business Income Taxes (UBIT). Due to the separate reporting rules under I.R.C. Section 512(a)(6) added by the Tax Cuts and Jobs Act (TCJA), all UBIT activities are separately reported on the IRS Form 990-T Return based on their 2-digit NAICS Codes. Therefore, all unrelated business income and expenses carried on by the University will be properly distributed and recorded in the revenue and expense accounts assigned to the unrelated business activity to determine federal UBIT.

II. DEFINITIONS

North American Industry Classification System (NAICS): the standard used by Federal statistical agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy.

III. POLICY STATEMENT

A. Separate UBIT Activity Reporting

Prior to the Tax Cuts and Jobs Act (TCJA), income and deductions from all unrelated business activities could be ~~summed together~~aggregated to determine the unrelated business taxable income (UBTI) or the net operating losses that could carry forward for up to 20 years. The TCJA's addition of I.R.C. Section 512(a)(6) requires that different types of unrelated business activities be separately reported.[1] For UC, ~~T~~the separate reporting ~~started~~ was effective in fiscal year 2019. The Regulations require that each distinct type of unrelated business activity be separately reported based on the 2-digit NAICS Codes. The I.R.C. Section 172 net operating losses generated from the separately reported

[1] I.R.C. Section 512(a)(6) does not require charitable contribution deductions and tax credits to be allocated among its various trades or businesses. ~~used by the activities that generated them.~~ The charitable contribution deductions and tax credits can be used to offset income from any unrelated business activity.

NAICS activities can be carried forward indefinitely, but can only be used to offset positive UBTI from the same NAICS activities. For example, losses from NAICS Code 54 Activities may only offset positive UBTI from NAICS Code 54 Activities. The use of these separately reported net operation losses are limited to:

- Up to 100% of positive UBTI for fiscal years 2019, 2020, and 2021, and
- Up to 80% of positive UBTI starting with fiscal year 2022.

Note that net operating losses generated before the TCJA with a 20-year carryforward period ~~, such losses~~ can offset up to 100% of UBTI from any NAICS Code activity.

B. Income

1. Unrelated Business Income

Gross income (revenue) from an unrelated trade or business activity regularly pursued by the University must be recorded in the revenue account(s) assigned to the activity. If no unique revenue account is assigned to the activity, the campus should maintain detailed records that segregate the department's unrelated business income from all other income. The department may use data or special sampling studies to estimate income attributable to the unrelated business activity.

2. Publication Activities

a. Advertising Income

Under the Code, income received by the University from the sale of commercial advertising in a campus newspaper, journal, or other periodical is gross income from an unrelated trade or business, and does not constitute an exempt activity (i.e., the publication and distribution of the readership content of the periodical). Accordingly, the allocation of depreciation and other ~~indirect~~overhead costs to advertising activities is subject to more stringent rules than for non-advertising unrelated business activities (see Section III.C~~B~~.4.).

b. Circulation Income

Circulation income refers to all income (other than advertising income) received by the University from the production, distribution, or circulation of a periodical. Circulation income also includes amounts realized from reprints of articles and the sale of back issues. Circulation income is generally not taxable, provided that the editorial content of the publication relates to the accomplishment of the University's exempt purposes.

3. Mixed Lease Income

Rents from real property are not subject to the UBIT.[2] In addition, the Code provides that rents from personal property leased with real property are excluded whereas the rents attributable to the personal property are incidental (i.e., 10% or less of the total rents received under the lease) as determined when the personal property is first placed in service. The general exclusion does not apply if the real or personal property rentals are based on net income or profits or if substantial services are provided for the convenience of the occupant.

In a mixed lease where the rent attributable to personal property is more than 50% of the total rent, none of the rent (including the rent from real property) is excludable from tax. If the rent attributable to personal property is 11% to 50% of the total rents, then only the personal property rent is taxable.

C. Direct Costs

1. Nature and Extent

Costs (or expenses) directly connected with the conduct of an unrelated business activity shall be charged to the activity. To qualify as a deduction in computing unrelated business taxable income, an item (1) must otherwise be an allowable deduction for income tax purposes and (2) also must be directly connected with the carrying on of the unrelated business activity. Under the Code, to be directly connected with the conduct of an unrelated business, the item must have a proximate and primary relationship to the carrying on of that business.

Under Business and Finance Bulletin (BFB) A-47, *Direct Costing Procedures*, examples of direct costs include salaries and wages (when the effort devoted and the benefit derived are directly identifiable with a specific activity); associated employee benefits costs; supplies and other general expenditures (such as travel, storehouse purchases, and garage and telephone charges); equipment purchases; and, for self-sustaining operations, equipment, depreciation, operations and maintenance of plant, and campus general administrative support recharges.

The cost of interest paid to third parties associated with fixed assets used in support of an unrelated business activity shall be charged to the activity as a direct cost. However, any interest paid or incurred during the production period of the fixed asset must be capitalized. Such fixed assets include buildings acquired or constructed, major reconstruction or remodeling of existing buildings, and the acquisition or fabrication of capital equipment. The interest paid must pertain to a debt of the

[2] Rents based on the tenants' gross revenue/sales are also not subject to the UBIT, although rent based on a tenant's net income or profits is taxed as UBTI.

University and must result from a debtor-creditor relationship based on an enforceable obligation to pay a fixed or determinable sum of money.

2. Expenses Attributable Solely to Unrelated Business Activities

Expenses attributable solely to the conduct of an unrelated business activity must be charged in full to the activity. For example, the costs of supplies used entirely in the conduct of an unrelated business activity are directly connected with the activity and should be charged in full to the activity.

3. Expenses Attributable to the Dual Use of Personnel or Facilities

When personnel or facilities are used to conduct both exempt activities and unrelated business activities, the expenses and similar items attributable to such personnel and facilities must be allocated between the two uses on a reasonable basis. Depreciation, operation, and maintenance costs associated with the use of a facility are allocated either by the corporate Indirect Cost System (ICS) or by comparable campus-based costing systems (see Section III.D~~C~~.). The distribution method which most accurately reflects the actual costs associated with conducting the unrelated business activity should be used to assign expenses to the activity. The method selected may vary with the nature of the cost item. However, the method adopted must be consistently applied.

a. Dual Use of Personnel

The salaries, benefits, and related expenses of personnel used both for exempt and unrelated business activities should be allocated based on the percent of time or effort devoted to each activity. The time or effort attributable to the unrelated activity may be documented by time records or by an annual statement of estimated effort signed by the employee.

b. Use of Facilities by the General Public

Athletic or parking facilities are examples of campus facilities. Direct costs associated with the use of a campus facility by the general public for a nonexempt purpose should be determined based on the percent of time the facility is actually used for exempt and nonexempt activities. For instance, if a facility is not available for use by the public at certain times because of campus events or activities, the costs attributable to these exempt functions should not be included in the allocation of costs to the unrelated activity. The remaining costs associated with the period(s) of time when the facility is available for use by both University members and the general public may be allocated based on the relative amount of sales revenue attributable to each user group. However, if the fee paid by the general public is larger because of a surcharge, the surcharge must be deducted from the unrelated revenue (and total revenue) before calculating the percentage of unrelated use to total use.

4. Expenses Attributable to Publication Activities

The Code contains special rules for the allocation of direct expenses attributable to the sale and publication of commercial advertising in a campus periodical. First, the total costs of the periodical must be established. Periodical costs consist of direct advertising costs and readership (or circulation) costs. Costs associated with teaching, research, or other exempt activities of the department may not be allocated to the periodical. Any costs pertaining both to the periodical and other exempt functions must be allocated on a reasonable and consistent basis.

After the total periodical costs have been identified, the costs benefiting advertising and readership activities must be determined.

a. Advertising Costs

Direct advertising costs consist of the following categories of expenses:

i) Costs attributable solely to the selling and publishing of advertising, such as salaries, commissions, transportation, travel, promotion, research, telephone, postage, artwork, and copy preparation may be charged in full to advertising.

ii) Salaries, benefits, and related expenses of personnel performing both advertising and circulation activities should be allocated based on the percent of time or effort devoted to each activity as provided in Section III.C~~B~~.3.a.

iii) Mechanical and distribution costs and other shared expenses benefiting both advertising and circulation activities may be allocated on the basis of advertising lineage (or page space) to total periodical lineage (or page space) if the departmental records are insufficient to permit a more precise allocation of such costs. Examples of mechanical and distribution costs include composition, press work, binding, paper, mailing, and bulk postage. Such expenses charged to advertising must not include any costs attributable to producing or distributing the periodical's readership content.

b. Readership Costs

Readership costs include those expenses directly connected with the production and distribution of the readership content of the periodical (to the extent not allocated to advertising under the policies above).

5. Expenses Attributable to Mixed Leases

Expenses attributable to a mixed lease are allocable to the taxable portion of the rental income, if any, depending on the percentage of personal property rents to the total rents received under the agreement. If the rents attributable to personal property are greater than 50% of the total rents received, then all direct costs; associated with the real and personal property rentals should be charged to the activity. If the rents attributable to personal property are 11% to 50% of the total rents received, then only those costs directly connected with the personal property may be charged to the activity.

D. ~~Indirect~~ Overhead Costs[3]

In addition to direct costs, ~~indirect~~ overhead costs will also be charged to an unrelated business activity in accordance with 2 CFR Part 200 - *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*.~~Office of Management and Budget Circular A-21, Principles for Determining Costs Applicable to Grants, Contracts, and Other Agreements with Educational Institutions.~~ The principles are designed to ensure that the Federal government bears its fair share of total accepted costs, determined in accordance with generally accepted accounting principles, except where restricted by law.

~~Indirect~~ Overhead costs are first allocated to the department conducting the unrelated business activity by the ICS or comparable campus-based systems. ~~Indirect~~ Overhead costs assigned to the department by the ICS are then allocated to the unrelated business activity using the procedures set forth in 2 CFR Part 200~~Circular A-21~~.

Note: Some ~~locations and~~ activities do not follow the overhead cost allocations in accordance with 2 CFR Part 200 because they do not have federal awards, such as activities conducted by the Office of the President and the alternative investments. For these ~~locations and and~~ activities, UC will report the exact overhead costs.

1. ~~Indirect~~ Overhead Cost Allocations-Nonadvertising Activities

Allocations of ~~indirect~~overhead costs to nonadvertising activities will be made from the following five cost pools (allocations from additional cost pools, such as the student administration and library cost pools, may be made, if appropriate, in conformance with 2 CFR Part 200~~Circular A-21~~):

a. Building Use Allowance

[3] Previously referred to as “indirect costs”.

The building use allowance is calculated by applying the 2% use allowance rate to the non-Federal acquisition cost of the building. The building use allowance for each building is then distributed to departments within the building based on the assignable square feet (ASF) occupied by the department. The departmental share of the building use allowance is allocated to the unrelated business activity based on the salaries and wages of the personnel charged to the activity.

b. Equipment Use Allowance and Depreciation

Equipment use allowance and depreciation costs are calculated for each department's equipment inventory. Only one method of cost recovery is used for each class of assets established in the University's CALCODE system. Under the use allowance method, the allowance is calculated at an annual rate of 6-2/3% of the non-Federal acquisition cost of the equipment. The depreciation method used is straight-line, less salvage value and any use allowance previously taken on the item. The period of useful life applicable to the asset is based on the CALCODE Equipment Class Table. The sum of the departmental equipment use allowance and depreciation costs is then allocated to the unrelated business activity based on the salaries and wages of the personnel charged to the activity.

c. Operations and Maintenance

The cost of operations and maintenance (OM) is allocated to buildings based on various methods depending on the nature of the cost item. For example, grounds maintenance costs are allocated based on the linear feet associated with the outside perimeter of the building; janitorial costs are allocated based on the number of janitors permanently assigned to each building; and utilities costs are allocated based on the building's consumption of gas and electricity. The OM costs are then aggregated by building and allocated to the departments within the building based on the ASF assigned to the department. The departmental share of the total building OM costs is allocated to the unrelated business activity based on the salaries and wages of the personnel charged to the activity.

d. General Administration

The costs of general administration (GA) incurred for each campus (e.g., Chancellor's Office, Accounting Office, etc.) are allocated to departments based on the modified total direct costs (MTDC) of each department. Under 2 CFR Part 200~~Circular A-21~~, MTDC consists of salaries and wages, fringe benefits, materials and supplies, services, travel, and subgrants and subcontracts up to $25,000 each. Then the departmental share of GA costs is allocated to the unrelated business activity based on the MTDC of the activity.

e. Departmental Administration

The costs of departmental administration (DA) consist of the department's own administrative costs, plus its share of the Dean's Office costs. The Dean's costs are allocated to departments under the Dean's responsibility based on the MTDC of each department. The department's allocation of the Dean's costs is then aggregated with the department's own administrative costs and distributed to the unrelated business activity based on the MTDC of the activity.

2. ~~Indirect~~Overhead Cost Allocations-Advertising Activities

The Code provides that ~~indirect~~overhead costs associated with a periodical must first be allocated to the exempt function of the periodical. Accordingly, allocations from the cost pools described in Section III.D~~C~~.1. will be made initially to circulation or readership activities. The share of the periodical's ~~indirect~~overhead costs attributable to advertising may be claimed only as an expense under the following conditions:

a) The advertising activity is profitable (i.e., gross advertising income of the periodical exceeds direct advertising costs); and

b) The circulation activity is not profitable (i.e., the total direct and ~~indirect~~overhead costs attributable to producing and distributing the readership content of the periodical exceed circulation income).

Thus, if the advertising activity is profitable, the excess, if any, of readership expenses over circulation income may be distributed to the unrelated activity. However, the allocation of the excess readership expenses may not result in an advertising loss (i.e., the advertising income can be reduced to zero but not less). Under these rules, therefore, advertising income will be taxed only if the periodical produces an overall profit.

E. Funding Tax Liability

Unrelated business taxable income (UBTI) reported by the University would be subject to the normal corporate income tax rate of 21% ~~under the changes made~~instituted by the TCJA~~s~~. UBTI ~~nrelated business taxable income i~~is defined in the Code and Regulations as the aggregate of gross income from each separate 2-digit NAICS Code activity's~~all of an organization's~~ unrelated businesses, regularly carried on, less the aggregate of deductions allowed with respect to all such separate unrelated businesses. Only the activities with positive UBTI will be summed together on page 2 of the IRS Form 990-T return. Any tax liability incurred by the University would be assessed against the ~~campuses~~ separate NAICS Code activities with ~~unrelated business taxable~~

~~income~~positive UBTI, as well as the locations that conducted the NAICS Code activities. The determination of each NAICS Code ~~campus' unrelated business taxable income~~activities' positive UBTI would be net of any carry forward or carry back losses ~~available to the campus~~generated by the separately reported NAICS Code activities, as well as any 20-year loss carry forward generated before the TCJA.

IV. COMPLIANCE / RESPONSIBILITIES

Function	Responsibilities
Executive Vice President-Chief Financial Officer	• Establishing and updating the policies set forth in this Bulletin.
Department Heads	• Ensure that income and expenses are distributed properly between the department's exempt functions and unrelated functions. • Ensure that detailed records are maintained that segregate the department's unrelated and related income if a unique revenue account is not assigned to the activity. • Ensure that costs associated with teaching, research, or other exempt activities of the department are not allocated to the publication activities. • Ensure that ~~indirect~~overhead costs assigned to the department by the ICS are then allocated to the unrelated business activity using the procedures set forth in 2 CFR Part 200~~Circular A-21~~. • Familiarize themselves with unrelated business income guidelines. • Notify the campus tax coordinator (or appropriate person) about activities which generate over $10,000 of outside revenue. • Consult with the campus tax coordinator (or appropriate person) when planning an activity that has unrelated business income tax potential.
UCOP ~~Finance Department~~Tax Services	• Determines the tax status of each new activity with a potential for generating unrelated business income, based on the Nonfinancial Questionnaire completed annually by the campus.

V. PROCEDURES

A. University's Exempt Organization Business Income Tax Return (Form 990-T)

Any organization exempt under Section 501(a~~c~~) of the Code must file Form 990-T if it has gross income from an unrelated trade or business of $1,000 or more. For the University, the ~~The~~ activities included in the tax return typically involve the sale of goods or services to the general public or outside organizations or the sale of consumer advertising in University publications. Since FY 1980-81, the University has filed a consolidated Form 990-T reporting ~~on~~ the unrelated business activities operated by the campuses. Going forward, the ~~The~~ consolidated Form 990-T reporting will include Schedules M of Form 990-T reporting ~~to report~~ the separate ~~activities based on the~~ 2-digit NAICS Code business activities.

~~s they are classified under.~~ The University, however, is not subject to the State franchise or corporation income tax. Because of its status as an instrumentality of the State of California, the University is not required to file annual tax or information returns with the Franchise Tax Board. ~~Should the University have~~ If California state income taxes are withheld from payments made to the University, the University ~~the University~~~~UC~~ can file a ~~n~~California Form 109 income tax return to ~~seek~~request a refund of the California state income tax withholdings.

In general, the net income derived from the conduct of a commercial-type activity operated by the University will be subject to Federal income tax if it is:

1) A trade or business,

2) Regularly carried on, and

3) Not substantially related to the University's exempt purposes (aside from the need of the University to raise funds or use the income in furtherance of its exempt purposes~~the use it makes of the profits~~).

However, even if an activity meets all three criteria the net income from the activity ~~it~~ may be exempt from taxation if the activity qualifies for ~~it satisfies~~ one of several exceptions contained in the Code. For example, income from activities performed by volunteers or for the convenience of University students, faculty, staff, or patients is ~~are~~ typically exempt from tax.~~.~~ In most cases, income derived from royalties, research, or rents from real property is also exempt from the unrelated business income tax.

B. Nonfinancial Questionnaire

The tax status of each new activity with a potential for generating unrelated business income will be determined by ~~the Finance Division~~Tax Services, Office of the President, based on the Nonfinancial Questionnaire completed annually by the campus. Completion of the Questionnaire may also be required for an established activity if the activity has changed its mode or scope of operations. Changes in the Code, Income Tax Regulations, federal court decisions, or other circumstances may also require that the Questionnaire be prepared for an activity. The income and direct expenses of the activities determined to be taxable will be reported to the ~~Finance Division~~UCOP Tax Services on the Financial Worksheet prepared for each activity. The Financial Worksheets and Instructions establish the mechanism for distributing the income and expenses of a department between its exempt and unrelated functions.

VI. RELATED INFORMATION

Business and Finance Bulletins

- A-47, *Direct Costing Procedures*~~University Direct Costing Procedures~~
- A-56, *Academic Support Unit Costing and Billing Guidelines*
- BUS-72, *Establishment of Auxiliary Enterprises*

Internal Revenue Code Sections:

- Section 172, Net Operating Loss Deduction
- Section 501, Exemption from tax on corporations, certain trusts, etc.
- Section 511, Imposition of tax on unrelated business income of charitable, etc., organizations
- Section 512, Unrelated business taxable income
- Section 513, Unrelated trade or business
- Section 514, Unrelated debt-financed income

Proposed Regulation Section 1.512(a)-6

2 CFR Part 200 - *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*.~~Office of Management and Budget Circular A-21, Principles for Determining Costs Applicable to Grants, Contracts, and Other Agreements with Educational Institutions.Office of Management and Budget Circular A-21, Principles for Determining Costs Applicable to Grants, Contracts, and Other Agreements with Educational Institutions~~

VII. FREQUENTLY ASKED QUESTIONS

Not applicable.

VIII. REVISION HISTORY

~~March~~ 3/15/~~, 19~~90: First~~Originally~~ Published

Revised:

~~November~~ 11/13/~~, 20~~07: Revised.

~~January~~ 1/17/~~, 20~~12: Revised to conform to the official policy template, and to update organizational titles.

~~9~~11~~1~~/30~~1~~/20~~17~~: Reformatted policy to revised template. Replaced OMB Circular A-21 with 2 CFR Part 200 and made other minor technical revisions. Updated to include changes made to UBTI and net operating loss reporting under the addition of I.R.C. Section 512(a)(6) due to the Tax Cuts and Jobs Act (TCJA)also referred to as P.L, 115-

97, and the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Added Agriculture and Natural Resources to the scope section.